Supreme Court, U.S.
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No. 92-683

In The

Supreme Court of the United States

October Term, 1992

DOUGLAS J. ERATH, *pro se*,

Petitioner,

vs.

XIDEX CORPORATION, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTION PRESENTED

The petition presents only a single question for the Court:

Did the Magistrate, the District Court and the Court of Appeals correctly determine that summary judgment was appropriate with respect to each of petitioner's claims?

PARTIES TO THE PROCEEDINGS

In addition to the parties set forth in the caption of the case in this Court, a list of the parties to the proceedings below, pursuant to Rule 34.2, includes respondents Craig M. Gentner and Bert L. Zaccaria. Messrs. Genter and Zaccaria were, at all relevant times, officers and directors of respondent Xidex Corporation.

The statement required by Rule 29.1 is set forth in the Appendix hereto.

TABLE OF CONTENTS

	Page
Question Presented	i
Parties to the Proceeding	ii
Table of Contents	iii
Table of Authorities	iv
Opinions Below	2
Statement of Jurisdiction	2
Statutory Provisions Involved	2
Statement of the Case	3
Reasons for Denying the Writ	6
I. The Decision Of The Court Of Appeals Affirming The Grant Of Summary Judgment Was Proper.	6
A. The Courts Below Properly Concluded That There Is No Cause Of Action Under SEC Regulation § 210.4-01(a), And That Even If There Were, Petitioner Has No Valid Claim.	7
B. The Courts Below Properly Rejected Petitioner's Claim Based On Section 18(a) Of The Exchange Act.	8

Contents

Page

C. The Courts Below Properly Rejected Petitioner's Claim Based On Section 29(b) Of The 1934 Act. 11

II. There Is No Conflict With Decisions In Other Circuits. 12

III. The Factual Determinations Made Below Were Correct And Do Not Warrant Further Review By This Court. 13

Conclusion 14

TABLE OF AUTHORITIES

Cases Cited:

Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986) 7, 11

Celotex Corp. v. Catrett, 477 U.S. 317 (1986) 7

Cort v. Ash, 422 U.S. 66 (1975) 8

Erath v. Xidex et al., 963 F.2d 378 (9th Cir. 1992) 2

Heit v. Weitzen, 402 F.2d 909 (2d Cir. 1968), *cert. denied*, 395 U.S. 903 (1969) 9

In re Equity Funding Corp. of America, 416 F. Supp. 161 (C.D. Cal. 1976) 8

In re Penn. Cent. Sec. Lit., 494 F.2d 528 (3rd Cir. 1974) .. 8

Contents

Page

Kaiser-Frazer v. Otis & Co., 195 F.2d 838 (2d Cir.), *cert. denied*, 344 U.S. 856 (1952) 12

NLRB v. Pittsburgh S.S. Co., 340 U.S. 498 (1951) 6

Ross v. A.H. Robins Co., 607 F.2d 545 (2d Cir.), *cert. denied*, 446 U.S. 946 (1979) 8, 9, 10

Sanders v. Thrall Mfg. Co., 582 F.Supp. 945 (S.D.N.Y 1983), *aff'd*, 730 F.2d 910 (2d Cir. 1984) 8

Slomiak v. Bear Sterns & Co., 597 F. Supp. 676 (S.D.N.Y. 1984) 12

Touche Ross & Co. v. Redington, 442 U.S. 560 (1979) ... 9

United States v. Johnston, 268 U.S. 220 (1925) 13

Wachovia Bank & Trust v. National Student Marketing, 461 F. Supp. 999 (D.D.C. 1978), *rev'd on other grounds*, 650 F.2d 342 (D.C. Cir. 1980) 10

Weisman v. Darneille, [1977 -78 Transfer Binder, Fed. Sec. L. Rep.] (CCH) ¶96,278 (S.D.N.Y. Jan. 6, 1978) 12

Statutes, Rule and Regulation Cited:

Section 18(a) of the Securities and Exchange Act of 1934 ("The 1934 Act"), 15 U.S.C. 78r(a) 2, 4, 8, 9, 10, 11

Section 29(b) of the 1934 Act, 15 U.S.C. 78cc(b) 2, 4, 5, 11, 12, 13

Contents

Page

SEC Regulation 210.4-01(a), 17 C.F.R. 210.40-01(a) 2, 7, 8, 11, 12

Fed. R. Civ. P. 56(c) 11

APPENDIX

Appendix A — Corporate Disclosure Statement Pursuant to Supreme Court Rule 29.1 ..... 1a

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

RESPONDENTS' BRIEF IN OPPOSITION

Respondents Xidex Corporation, Craig M. Gentner and Bert L. Zaccaria (collectively "Xidex") respectfully submit this brief in opposition to petitioner's request that a writ of certiorari issue to review the decision and judgment of the United States Court of Appeals for the Ninth Circuit, filed on May 1, 1992, which affirmed the Order and Judgment of the United States District Court for the District of Arizona, filed February 7, 1991. An Advisory Opinion of the United States Magistrate, filed June 11, 1990, provided the basis for the decisions in the District Court and the Court of Appeals.

OPINIONS BELOW

The Order of the Court of Appeals is reproduced in Appendix D to the Petition ("Pet. App.") and is reported at 963 F.2d 378. The Order of the District Court (Pet. App. B) and the Opinion of the Magistrate adopted by the District Court (Pet. App. A), were not officially reported but may be found in *Erath v. Xidex et al.*, No. CIV-89-198TUCAM(NF), 1991 WL 338322 (D. Ariz. Feb. 7, 1992).

STATEMENT OF JURISDICTION

A petition for rehearing was filed in the Court of Appeals, which was denied on July 1, 1992. The petition for a writ of certiorari was initially filed on September 24, 1992 and finally perfected on October 19, 1992.[1] The jurisdiction of this Court is sought to be invoked under 28 U.S.C. § 1254.

STATUTORY PROVISIONS INVOLVED

The statutes and regulation involved in the proceeding below are as follows:

Section 18(a)
Securities Exchange Act of 1934 . . . . . 15 U.S.C. § 78r(a)

Section 29(b)
Securities Exchange Act of 1934 . . . . . 15 U.S.C. § 78cc(b)

SEC Regulation § 210.4-01(a) . . . . . 17 C.F.R.§210.40-01(a)

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1 On October 19, 1992, respondents received copies of the instant petition, corrected to conform with the Rules of this Court at the direction of the Clerk of the Court. The time for filing a brief in opposition is therefore measured from that date.

Pertinent portions of these provisions are reproduced in the Appendix to the Petition (Pet. App. F-G, O).

STATEMENT OF THE CASE

This action arises from certain investments made by petitioner, Douglas J. Erath, beginning in late December of 1986. By August of 1988, petitioner's investment decisions had proved, with twenty-twenty hindsight, to be unwise. He seeks to hold respondents responsible for the losses.

Petitioner purchased 112,000 warrants issued by Xidex Corporation (the "Xidex Warrants"). The Xidex Warrants were sold pursuant to a written agreement (the "Warrant Agreement") (Pet. App. Q), which provided that, subject to certain adjustment provisions clearly set forth in Section 11 thereof (the "Adjustment Provisions"), the Xidex Warrants entitled the holder to purchase one share of Xidex common stock prior to April 16, 1993 at $20.415 per share (or earlier if the average closing price of Xidex common stock exceeded $30.62 per share for 180 consecutive trading days). The Adjustment Provisions addressed, among other things, how the Xidex Warrants would be treated in any subsequent acquisition or merger of Xidex.

The Xidex Warrants and the Warrant Agreement were registered with the Securities and Exchange Commission (the "SEC"), copies of the Warrant Agreement were freely available to the public, and the terms of the Warrant Agreement (including the Adjustment Provisions) were at all relevant times incorporated in the 10-K Reports filed with the SEC by Xidex (Pet. App. A, pp. a51-52).

On July 12, 1988, Xidex and a subsidiary of Anacomp, Inc. ("Anacomp") announced plans for a merger at a price of $10 per share of Xidex common stock, which was subsequently reduced to

$9.25 per share following the completion of due diligence. By reason of the merger, the Xidex Warrants became convertible under the Warrant Agreement into Xidex common stock at $9.25 per share upon payment by the holder of $20.415 per share. Put simply, the Xidex Warrants were decidedly "out of the money" when the merger was announced and expired worthless upon consummation of the merger, thereby resulting in a loss to petitioner.

Obviously disappointed that his investment in Xidex Warrants had proved unwise, petitioner determined to lay the blame for his losses on Xidex and two of its senior executives. To that end, he commenced this action in April of 1989, alleging violations of various provisions in the Securities and Exchange Act of 1934 (the "Exchange Act") and a regulation promulgated by the SEC thereunder.

The first claim in the Complaint asserts that mention of the Adjustment Provisions in the Xidex Warrants should have been made in footnote 2 of the consolidated financial statements of Xidex that were part of both its 1986 and 1987 Annual Reports to Shareholders ("Annual Reports"). Xidex's failure to do so, petitioner further alleges, constituted a material omission in violation of SEC Regulation § 210.4-01(a), 17 CFR § 210.4-01(a), which concerns the preparation of financial statements by accountants (Pet. App. A, p. a17).

The second claim in the Complaint alleges that, by reason of the same footnote 2, respondents are also liable under Section 18(a) of the Exchange Act, 15 U.S.C. § 78r(a), which provides redress to a purchaser who has detrimentally relied on misleading statements contained in a document "filed" by the issuing company with the SEC (Pet. pp. 3-4).

Petitioner's final claim in the Complaint is based on Section 29(b) of the Exchange Act, 15 U.S.C. § 78cc(b), which states that a

purchaser may sue for rescission of any "contract" made in violation of any SEC rule or regulation. In essence, petitioner asserts that the violations alleged in his first and second claims entitle him to relief under Section 29(b) (Pet. pp. 25-27).

Respondents answered the Complaint, denying any liability to petitioner. They argued that footnote 2 in the financial statements, which lies at the heart of all of petitioner's claims, does not purport to describe the Xidex Warrants or an acquisition/merger of Xidex. To the contrary, the footnote, entitled "Acquisitions," discusses various corporations that had been acquired *by* Xidex and mentions the Xidex Warrants only in passing because they were part of the method used to finance these acquisitions.

Petitioner agreed below to discontinue this action if his claims were found meritless by an objective, impartial party. Accordingly, the parties mutually consented to present their claims and defenses to United States Magistrate Nancy Fiora in a summary trial, which was held on April 17, 1990 (Pet. App. A, p. a1). In an Advisory Opinion, filed June 11, 1990, Magistrate Fiora ruled against petitioner, identifying a host of legal and factual deficiencies in each of the claims in the Complaint. Nevertheless, in complete defiance of his prior agreement to abide by the outcome before the Magistrate, petitioner refused to discontinue this case. Therefore, respondents moved in the District Court for summary judgment, which was granted by District Judge Alfredo Marquez on February 7, 1991, based upon the Magistrate's Advisory Opinion.

Petitioner then appealed to the Court of Appeals for the Ninth Circuit. On May 1, 1992, the Court of Appeals issued a decision affirming the district court's order granting summary judgment (Pet. App. D, p. a62). A petition for rehearing filed by petitioner, with a suggestion for rehearing *en banc*, was denied on July 1, 1992 (Pet. App. E, p. a63). Petitioner filed his petition for a writ of certiorari on September 24, 1992.

REASONS FOR DENYING THE WRIT

The petition in this proceeding fails to satisfy *any* of the criteria traditionally applied by this Court in determining whether to grant a writ of certiorari. The courts below properly adhered to both the letter and spirit of the statutes and regulation upon which petitioner claims to rely, and they applied the law in a manner that is fully consistent with the undisputed record facts and the decisions rendered by other courts that have confronted similar issues. Indeed, petitioner has failed to identify even a single decision rendered by any court that casts doubt upon, much less conflicts with, the outcome reached here. Moreover, both the claims and the facts in this proceeding are sufficiently unique that little precedential value is likely to be derived by the lower courts from any decision this Court might render. Thus, the petition presents no broad questions of general importance beyond the resolution of this specific controversy. On that basis alone, the writ should be denied. *See NLRB v. Pittsburgh S.S. Co.*, 340 U.S. 498, 502 (1951) (noting that certiorari is granted only in cases involving principles of importance to the public as distinguished from the parties).

I.

THE DECISION OF THE COURT OF APPEALS AFFIRMING THE GRANT OF SUMMARY JUDGMENT WAS PROPER.

Investments in securities are not risk free. That is particularly true of investments in so-called derivative securities that, by their very nature, are subject to significant market risks arising from, among other things, the change in value of the underlying securities to which they are referenced. This action concerns an investor intent on transforming a corporate issuer of derivative securities into an insurer against losses in such securities. The law imposes no such obligation on a corporation and its senior officers,

as the United States Magistrate, the District Court and the Court of Appeals all found.

Summary judgment is required if, viewing the evidence most favorably to the opposing party, there is no genuine issue of material fact and the moving party is entitled to a judgment as a matter of law. Fed. R. Civ. P. 56(c). *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986). It is settled that a complete failure of proof concerning essential elements in a plaintiff's claim necessarily renders all other facts immaterial. *Id.* at 331; *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249-250 (1986). Moreover, a party opposing a properly supported motion for summary judgment may not rest upon mere allegations or denials contained in the pleadings. *Anderson v. Liberty Lobby*, 477 U.S. at 248. The courts below adhered to these principles in determining that summary judgment was appropriately granted on petitioner's claims.

It is essential to recognize at the outset that footnote 2 in the Financial Statements of Xidex did not mention the Adjustment Provisions in the Xidex Warrants because *the Xidex Warrants were not the subject matter of the footnote.* Properly understood, petitioner's claims first seek to transform the subject matter of the footnote at issue and then fault Xidex for failing to make proper disclosures concerning this different subject matter.

A. The Courts Below Properly Concluded That There Is No Cause Of Action Under SEC Regulation § 210.4-01(a), And That Even If There Were, Petitioner Has No Valid Claim.

Petitioner argued below that a private right of action exists under Section 13(a) and Regulation § 210.4-01(a) promulgated thereunder, and that Regulation § 210.4-01(a) applies to financial statements contained in Annual Reports to Shareholders (Pet. App. A, pp. a23-24). It is unclear whether petitioner has abandoned this claim in the petition. However, it is clear in any event that

petitioner has no valid claim under Section 13 of the Exchange Act and the rules promulgated thereunder, as the courts below found.

The Magistrate held that there is no private right of action under Section 13 of the Exchange Act for the alleged violation of rules applicable to accountants preparing financial statements, such as Regulation § 210.4-01(a) (Pet. App. A, p. a27). That conclusion is mandated by the analytical framework set forth by this Court in *Cort v. Ash*, 422 U.S. 66 (1975). Other courts considering the issue have reached precisely the same conclusion. *See, e.g., In re Penn. Cent. Sec. Lit.*, 494 F.2d 528, 540-41 (3d Cir. 1974); *Sanders v. Thrall Car Mfg. Co.*, 582 F. Supp. 945, 959-61 (S.D.N.Y. 1983), *aff'd*, 730 F.2d 910 (2d Cir. 1984); *In re Equity Funding Corp. of America*, 416 F. Supp. 161, 190 (C.D. Cal. 1976). The Magistrate properly concluded that petitioner's exclusive remedy for any violation of Section 13 would lie under Section 18 of the 1934 Act (Pet. App. A, p. a27).

Even if an implied right of action did exist under Section 13, Regulation § 210.4-01(a) does not apply to the footnotes in the Xidex Annual Reports about which petitioner complains. As the Magistrate concluded, the disclosure requirements of Section 13 and Regulation § 210.4-01(a) apply to a corporation's *10-K Reports*, and there was no misleading omission with respect to the 10-K Reports filed by Xidex (Pet. App. A, p. a23). Indeed, the Adjustment Provisions in the Xidex Warrants were expressly incorporated in the 10-K Reports (Pet. App. A, p. a41-42).

Thus, petitioner has no claim under Regulation § 210.4-01(a).

B. The Courts Below Properly Rejected Petitioner's Claim Based On Section 18(a) Of The Exchange Act.

By its express terms, Section 18(a) of the Exchange Act permits recovery only if a person relies on misleading statements contained in a document "filed" with the SEC. *See Ross v. A.H.*

Robins Co., 607 F.2d 545, 552-53 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980). Section 18(a) also requires that a plaintiff show that the allegedly misleading statement in such a document affected the price at which he bought or sold a security. *See Touche Ross & Co. v. Redington*, 442 U.S. 560, 572 (1979). Petitioner has not, and cannot, satisfy either requirement, as the courts below found.

The 1986 and the 1987 Annual Reports of Xidex were not "filed" documents. *See Heit v. Weitzen*, 402 F.2d 909, (2d Cir. 1968), *cert. denied*, 395 U.S. 903 (1969) (holding annual reports to shareholders are not "filed" documents for the purpose of establishing § 18(a) liability). Petitioner does not contend otherwise. Nonetheless, he argues that the footnotes to the financial statements in the Annual Reports, standing alone, were "filed documents" merely because they were subsequently incorporated into the 10-K Reports by reference — along with many statements expressly addressing the Xidex Warrants, and the Adjustment Provisions, which he claims must be ignored. (Pet. pp. 14-15).

Petitioner also theorizes that whether a particular statement violates Section 18(a) must be judged at the time that the statement was initially made, as opposed to the time it is incorporated in a filed document (Pet. pp. 15-16). Accordingly, he concludes that the failure to include the Adjustment Provisions in the footnotes to the 1986 and 1987 Annual Reports created a violation of Section 18(a) *at the time the Annual Reports were issued*, which was well before the pages containing the Notes to those Annual Reports were incorporated by reference into the "filed" 10-K Reports (Pet. App. A, p. a12).

The Magistrate quite properly rejected petitioner's arguments, noting that they would permit a claimant to recover under Section 18(a) for statements that were not a part of any

document filed with the SEC at the time that the claimant allegedly relied on them (Pet. App. A, p. a12). The Magistrate also found unpersuasive, and rightly so, petitioner's suggestion that it is permissible under Section 18 to view the footnotes in the Annual Reports "in isolation", thereby ignoring the fact that the Adjustment Provisions in the Xidex Warrants were expressly incorporated into the 10-K Reports — the filed documents upon which petitioner claims to rely (Pet. App. A, p. a13).

The Magistrate also correctly concluded that petitioner fails to satisfy the reliance requirement in Section 18 (Pet. App. A, p. a35). Petitioner admitted during his sworn deposition testimony that he had never seen or relied on the actual 10-K Reports upon which he now attempts to base his claims (Pet. App. A, pp. a30-32, a35). Thus, the Magistrate ruled as a matter of law that petitioner could not show that he had knowledge that the 1986 and 1987 Xidex Annual Reports were "filed" when he purchased the Xidex Warrants. Contrary to petitioner's suggestion, that ruling is fully consistent with *Wachovia Bank & Trust v. National Student Marketing*, 461 F. Supp. 999, 1006, n. 13 (D.D.C. 1978), *rev'd on other grounds*, 650 F.2d 342 (D.C. Cir. 1980). In *Wachovia*, the court concluded that reliance in a Section 18(a) case requires that the plaintiff have knowledge that the documents were filed with the SEC at the time of the purchase because it is that knowledge, and that knowledge alone, that serves to justify any reliance. *Id.* As the Magistrate recognized (Pet. App. A, pp. a12-13), interpreting Section 18(a) in this manner furthers the narrow and particularized purpose of the statute: "encouraging use of and reliance upon records filed with SEC." *Ross v. A.H. Robins Co.*, 607 F.2d 545 at 556.

Petitioner overlooks that quite apart from these deficiencies, any one of which is sufficient to doom his claim under Section 18, he also admitted that he could not prove that the price at which he purchased or sold the Xidex Warrants was affected in any way by

the allegedly misleading omission in footnote 2 (Pet. App. A, p. a57-58). Indeed, the petitioner never adduced one iota of evidence to show that the alleged omissions in the Annual Reports led to his losses. That renders petitioner's "forced sale" theory completely spurious.

Finally, the Magistrate found, as a matter of undisputed fact, that respondents established their good faith, and therefore enjoy an absolute bar to Section 18(a) liability (Pet. App. A, p. a58). Petitioner failed to develop any evidence to the contrary, as required under Rule 56. *See Anderson v. Liberty Lobby*, 477 U.S. at 248.

Accordingly, summary judgment was properly granted with respect to petitioner's Section 18 claim.

C. The Courts Below Properly Rejected Petitioner's Claim Based On Section 29(b) Of The 1934 Act.

Section 29(b) of the Exchange Act provides that a plaintiff may rescind any "contract" made in violation of any rules or regulations of the SEC. Petitioner argues that he is entitled to such a remedy because Xidex violated either Regulation § 210.4-01(a) or Section 18. In such event, according to petitioner, his purchase of the Xidex Warrants is unlawful within the meaning of Section 29(b) (Pet. p. 26).

As a threshold matter, the Magistrate correctly found that under Section 29(b) the relevant "contract" is the Warrant Agreement, and that there is no illegality with respect to it (Pet. App. A, pp. a54-56). There is no basis in fact or logic to contend otherwise. The Magistrate also properly concluded that the footnotes in the 1986 and the 1987 Annual Reports of Xidex are "collateral" to the Warrant Agreement, and therefore not actionable under Section 29(b) (Pet. App. A, p. a57). That holding is consistent with the rulings reached by other courts in similar

circumstances. *See, e.g., Slomiak v. Bear Sterns & Co.*, 597 F. Supp. 676, 681-82 (S.D.N.Y. 1984) (Pet. App. A, pp. a54-57).

Finally, the Magistrate also properly found that since petitioner's claims under Regulation § 210.4-01(a) and Section 18 were not meritorious, he failed to show any predicate for his claim under Section 29(b) (Pet. App. A, p. a57-58).

Accordingly, the courts below properly rejected petitioner's Section 29(b) claim.

II.

THERE IS NO CONFLICT WITH DECISIONS IN OTHER CIRCUITS.

As noted above, petitioner has failed to demonstrate any conflict between the courts of appeal concerning the legal issues decided by the courts below.

He mistakenly cites *Weisman v. Darneille*, [1977-78 Transfer Binder, Fed. Sec. L. Rep.] (CCH) ¶ 96,278 (S.D.N.Y. Jan. 6, 1978) concerning his claim under Section 18(a). In *Weisman*, the district court speculated that a claimant might have standing to sue as a "seller" under Section 18 based upon a forced sale theory. However, nothing in that case suggests that baldly alleging that there was a "forced sale" alleviates the obligation to establish that an allegedly misleading omission affected the price at which the securities were bought or sold. Petitioner adduced no competent evidence to support his theory.

Equally misplaced is petitioner's reliance on *Kaiser-Frazer v. Otis & Co.*, 195 F.2d 838 (2d Cir. 1952) to support his Section 29(b) claim. Nothing in *Kaiser-Frazer* cures petitioner's complete failure to show that there was any illegality or violation of any SEC

rule or regulation with respect to the Warrant Agreement. Nor does that case stand for the proposition that footnotes in annual reports to shareholders dealing with a topic completely distinct from the sale of warrants may be transformed into a "contract" with respect to those warrants for purposes of Section 29(b).

No reported decision by any court supports any of petitioner's arguments.

III.

THE FACTUAL DETERMINATIONS MADE BELOW WERE CORRECT AND DO NOT WARRANT FURTHER REVIEW BY THIS COURT.

Petitioner's arguments necessarily invite this Court to overturn the factual determinations made below. However, it has long been the rule that the Court will not grant certiorari to review the factual determinations made by lower courts. *See United States v. Johnston*, 268 U.S. 220, 227 (1925) ("We do not grant a certiorari to review evidence and discuss specific facts."). Nothing in this case suggests that a departure from this well-conceived rule is appropriate.

CONCLUSION

Accordingly, for all the foregoing reasons, petitioner's request for a writ of certiorari should be denied.

Dated: November 18, 1992

Respectfully submitted,

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APPENDIX A – CORPORATE DISCLOSURE STATEMENT PURSUANT TO SUPREME COURT RULE 29.1

Anacomp A.B. (Sweden)
Anacomp A/S (Denmark)
Anacomp A/S (Norway)
Anacomp B.V. (formerly DatagraphiX (Netherland) B.V.)
Anacomp Belgium S.A. (formerly DatagraphiX W.V. (S.A.))
Anacomp Canada, Inc. (formerly DatagraphiX Canada, Inc.)
Anacomp California Inc.
Anacomp do Brasil Ltda.
Anacomp GesmbH
Anacomp GmbH (formerly DatagraphiX GmbH)
Anacomp Holdings Limited
Anacomp Inc.
Anacomp International, N.V.
Anacomp Italia SRL
Anacomp Japan, Ltd.
Anacomp Limited (formerly DatagraphiX Limited)
Anacomp O.Y (Finland)
Anacomp Pty Limited
Anacomp S.A.
Computer Services Corporation Electronic Data Preparation Corporation
DACA International B.V.
Datamagnetics GmbH
Dysan Overseas Technical Service and Sales Corporation
Florida A.A.C. Corporation
Kelvar Microfilm, Inc.
Stromberg DatagraphiX International Corp.
Sun-Flex Industries of Puerto Rico, Inc.
U.S.A. Communications, Inc.
Xidex (Pty.) Ltd.
Xidex (U.K.) Limited
Xidex Asia Limited

Appendix A

Xidex B.V.
Xidex Corporation S.A.
Xidex Development Company
Xidex GmbH
Xidex International Sales Corp.
Xidex Magnetics S.A.
Xidex New Zealand Limited
Xidex Pty. Limited
Xidex S.A.R.L.